JA GLYNN
PRIVATE WEALTH

Fourth Quarter 2019

INVESTMENT COMMENTARY

Economic Outlook

There is much media discussion and investor concern about what may be ahead in 2020 and beyond. Indeed, similar concerns came up at the beginning of 2019. It is not wise to manage investments based on emotions that the market is "due" for a correction, even while pundits foster this fear. Macro data points indicate mostly slowing economies in the U.S. and overseas, and domestic industrial production had its worst annual growth since October 2016. However, this still correlates to GDP growth in the 1.5%-2.0% range, which is hardly recessionary.

Adding to stability, the Fed is accommodative and watchful, and the twelve Federal Reserve banks appear unified on the current policy stance. In contrast to the fall of 2018, the markets appear to be comfortable that the Fed is not making a policy mistake. On the other hand, the growing Fed balance sheet may be giving risk assets an artificial boost and we are watchful over this concern. It could be a long time before the Fed is compelled to develop a long-term solution, especially since some of the dysfunction in the capital markets is related to permanent regulatory policies in the banking industry. For now, we expect the Fed's monetary approach to be "business as usual."

It's important to incorporate multiple points of data, to patiently parse through the vast quantities of often noisy and misleading information, using research and experience to come to wise conclusions. Data can be easily mis-interpreted, particularly when using backward-looking information to forecast the future. The economic transformation from the decades of the past to the current environment of central bank involvement and low interest rates has rendered conclusions from backward-looking data even less reliable. Across many different data sets, the past measurements do not reflect the way the present has evolved and will continue to change. This is an exciting environment that really speaks to the strength of active and flexible investment management.

Equity Strategies

Performance across our growth equity strategies in 2019 was particularly robust. *Please contact us for specific details on investments and performance.*

The strength of the US equity market in 2019 was really a story of a group of large firm's substantial outperformance, Microsoft (up 58%) and Apple (up 89%) at the top of the list. In addition, the Fed cut interest rates by one quarter percent on three occasions, and that certainly helped asset prices. The Fed's repurchase and Treasury bill purchase operations continued to provide ample liquidity into and beyond the year-end, seeking to discourage a repeat of September's overnight federal-funds rate spike.

Economic data overall has not been as dire as previously anticipated and trade negotiations have come back from the precipice. The bond yield curve is no longer inverted and has steepened moderately since last August. U.S. housing starts jumped 16.9% in December, the most since October 2016 and the highest level in 13 years, as supply responded to stronger demand. In China, while growth has decreased compared to previous years, consumer demand continues to be selectively strong. A broad European recession is likely which would escalate monetary easing by the European Central Bank, likely weakening the Euro more. This could strengthen the US dollar and make the U.S. an even more attractive investment destination. This could also lead to more tension in the Eurozone, which would continue to support the status of the US dollar (and Treasuries) as the reserve currency.

Although we are cognizant of softness in some domestic sectors, the near fully employed American consumer is still spending and global corporations are still investing heavily in technology and research/development as a competitive strategy to expand sales and margins. We focus on owning companies that are fighting hard to be competitive and genuinely growing their earnings through their business operations. Our actively managed, highly selective strategies all had robust earnings growth in 2019 relative to the broad equity market, a key factor to outperforming the market and a fundamental basis for weathering volatility when it arrives.

We think that 2020 has a far wider range of possibilities than 2019; we have structured our portfolios to potentially benefit if the capital markets turn out to be supportive and we want to preserve capital in the event of significant volatility. As economic growth decelerates, strong companies with competitive advantages can often benefit more. These companies excel and expand relative to their competitors and this is an important factor when evaluating potential investment choices. Active management is critical under these scenarios and the professionals at JA Glynn Private Wealth / JAG Capital Management are intensely focused on this.

We look for specific sectors that may benefit from economic slowdowns, for example technology consulting. As companies compete and evolve to be more efficient and data-driven in order to counteract economic deceleration, consulting services grow. We also contemplate the multiple paths that politics may take this year, seeking sectors that are more or less stable, regardless of which political party ultimately wins each branch of government, and minimizing sectors that are particularly affected by specific policy changes.

One large concern we have is the enormous flow of assets into passive investments that extend duration, leverage and superficial liquidity. American investors are even buying substantial amounts of negative-yield European debt through bond index funds and believing this is diversification. The wise approach in today's environment is to minimize exposure to the broad market indexes, and to selectively invest in companies that are visibly growing their earnings and free cash flow, keeping their debt levels manageable, dominating their industries, and exhibiting strong long-term growth characteristics. Individual companies must be thought of and evaluated differently than "the market" as a whole. Some companies will be significantly better; some will be far worse. Vigorous research, constant evaluation of the data and separating the noise, flexibility, and disciplined implementation is critical.

Adaptive Yield

Adaptive Yield's annual gross distribution yield ended in 2019 at about 8.34%* compared to the Barclays Aggregate Bond index with a 30-day SEC yield of around 2.25%. Of note, the 10-year US Treasury yield started the year at 2.7% and finished the quarter at 1.9%. *Please contact us for specific details on investments and performance.*

Adaptive Yield meets current and projected income needs at a prudent amount of risk and volatility, targeting a distributable yield of 4% over the 10-year Treasury rate. Our experience has shown that this is an achievable goal for this investment strategy. For years, we have seen a global "reach for yield" through investments which are often misunderstood by investors. We monitor the credit markets with this as a top of mind concern as investors – large funds as well as individuals – become more desperate to generate yield to meet goals. Continuing into the fourth quarter of 2019, credit spreads trended lower, resulting in spreads moving to within striking distance of multi-year lows. This suggests continued strong bid from investors, particularly in high-yield bonds which we are avoiding. Bloomberg's Investment Grade Index has increased duration to eight years, and bond investors could potentially be more exposed to painful setbacks if/when interest rates move up.

U.S. rates are still higher than those available in most of the developed world. Fed accommodation, ample global demand, less supply, and a perceived "Goldilocks/Just Right" view of this environment should keep credit well supported. Within this context, we find several attractive investment opportunities in high credit quality specialty finance, where we have invested for several years now. There is also ample opportunity in infrastructure investing, particularly globally as US dollar strength remains high and cost of capital remains low. We will adjust investments at the point interest rates change, but for now it's business as usual for Adaptive Yield.

Please let us know if you would like to discuss specific details about our thoughts or investment strategies. As the new year begins, we are grateful for your confidence in us to navigate the uncertainties in a sensible way.

Warmest regards,

JoAnn and Mike

* This strategy yield is calculated by taking the declared, annualized forward distribution for each strategy investment divided by the period ending investment price. The Bloomberg Barclays Aggregate Bond Index yield represents the 30 Day SEC Yield

JoAnn Seagren
847.712.0800 | jseagren@jaglynnpw.com

Mike Kimbarovsky
847.452.7716 | mkimbarovsky@jaglynnpw.com